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**IN THE UNITED STATES BANKRUPTCY COURT**  
**DISTRICT OF ARIZONA**

In re:  
GREEN FUEL TECHNOLOGIES, L.L.C.  
Debtor.

Case No. 2:17-bk-00594-BMW

Chapter 11

**OBJECTION TO EMERGENCY  
MOTION FOR ORDER  
AUTHORIZING DEBTOR TO PAY  
CERTAIN PREPETITION CLAIMS IN  
THE ORDINARY COURSE OF ITS  
BUSINESS**

**Hearing Date: March 9, 2017**  
**Hearing Time: 11:00 a.m.**

Secured Creditor UMB Bank, n.a. ("UMB"), by and through undersigned counsel, hereby submits this objection (the "Objection") to the *Emergency Motion For Order Authorizing Debtor To Pay Certain Prepetition Claims In The Ordinary Course Of Its Business* filed by the above-captioned debtor (the "Debtor") on February 15, 2017 [DE #45] ("Motion").

**MEMORANDUM OF POINTS AND AUTHORITIES**

**I. INTRODUCTION.**

The Debtor asks the Court to approve payment of prepetition claims totaling over \$260,000, placing misguided reliance on Bankruptcy Code section 105 and the doctrine of necessity. Absent circumstances not applicable here, the Bankruptcy Code prohibits the requested payment of prepetition claims outside of the context of a plan of reorganization. All creditors remain at risk, as the estate is at or near administrative insolvency. No legal basis permits preferential payments to the unsecured creditors designated by the Debtor to the detriment of all

1 other estate creditors. Accordingly, the Court should deny the Motion, leaving undisturbed  
2 Congress' specified priority scheme.

3 **II. RELEVANT FACTUAL BACKGROUND.**

4 1. On January 20, 2017 ("Petition Date"), the Debtor filed a voluntary petition for  
5 relief under Chapter 11 of Title 11 of the United States Code, 11 U.S.C. §§ 101 *et seq.*  
6 ("Bankruptcy Code").

7 2. The Debtor continues to operate its business as a debtor in possession under  
8 Sections 1107 and 1108 of the Bankruptcy Code.

9 3. This Court has jurisdiction over the Debtor's bankruptcy case pursuant to 28 U.S.C.  
10 §§ 157 and 1334. This is a core proceeding under 28 U.S.C. § 157(b)(2).

11 4. The Debtor owes UMB no less than \$729,379.77 pursuant to a prepetition line of  
12 credit loan (as the same has been modified from time to time, "Loan") extended by UMB on April  
13 30, 2012, that is secured by properly perfected liens in virtually all of the Debtor's personal  
14 property assets ("Collateral"). *See* DE #20, Exs. A-B. The Debtor admits that it owes UMB  
15 \$701,000. *See* DE #38, at 8 ¶ 2.2.

16 5. By August 2015, the Debtor's financial condition had materially declined causing a  
17 number of covenant defaults under the Loan. The Debtor acknowledged such defaults in a series  
18 of six forbearance agreements, the first of which is dated August 31, 2015, and the last of which  
19 expired by its own terms on November 30, 2016. The Debtor failed to find a replacement lender  
20 or otherwise repay the Loan, and refused to comply with UMB's lawful demand for repayment in  
21 full. The Debtor further breached its agreement with UMB by diverting nearly \$700,000 in  
22 customer collections to new accounts opened at another financial institution in order to thwart  
23 UMB's recovery efforts.

24 6. UMB commenced a state court lawsuit over a month later, on January 10, 2017,  
25 seeking (among other things) the appointment of a receiver. The Debtor filed this case on January  
26 20, 2017, less than one hour before the return evidentiary hearing on the receivership application.  
27  
28

7. Between November 30, 2016, and the Petition Date, according to the Debtor's own records, the Debtor's total accounts receivable has declined by nearly \$700,000 - down from nearly \$1.1 million to just over \$400,000. *See* DE #38, Exs. C-D.

8. Even after collecting receivables of nearly \$700,000, the Debtor asserted a Petition Date cash balance of \$230,000 - a \$450,000 cash depletion in less than two months immediately prepetition. *See* DE #38, at 1 ¶ 5.

9. On January 24, 2017, the Debtor filed a motion seeking authority to use cash collateral. DE #9. UMB objected to the cash collateral motion and filed a separate motion seeking to convert or dismiss the Debtor's bankruptcy case for cause. DE ##26, 43.

10. The day before the evidentiary cash collateral hearing, the Debtor filed the Motion. At the conclusion of the evidentiary hearing, the Court authorized the Debtor's interim use of cash collateral only through March 9, 2017, in order to evaluate the Motion. *See* DE #48.

11. In the Motion,<sup>1</sup> the Debtor seeks authority to pay prepetition claims totaling \$260,093.58, as follows: (i) Independent Electric Supply ("IES") in the amount of \$48,270.79; (ii) Marco Crane & Rigging ("Marco") in the amount of \$17,884.80; (iii) Pantheon in the amount of \$49,962.02; (iv) Gerdau in the amount of \$25,934.83; (v) Ritoch Powell & Associates in the amount of \$101,808.46; (vi) Smith County Survey in the amount of \$13,450.00; and (vii) Soils Engineering in the amount of \$2,782.68. The Debtor asserts that the inability to pay these creditors' prepetition claims *could* result in the imposition of liens on non-estate property or result in complaints or bond claims; *could* jeopardize future projects the Debtor *hopes* to obtain; and *may* jeopardize the Debtor's ability to collect some accounts receivable due to the Debtor. *See* Motion, at 5-7.

### III. LEGAL ARGUMENT.

Bankruptcy Code section 507 specifies the priority scheme for payment of claims in a bankruptcy case. In the Motion, the Debtor relies upon the equitable authority of Section 105, which cannot be used to circumvent express Bankruptcy Code provisions; and the "necessity of

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<sup>1</sup> The declaration of the Debtor's principal, John Casey, that accompanies the Motion ("Declaration") [DE #46], appears to omit Page 4. UMB reserves all of its rights relating thereto.

1 payment” doctrine that is expressly rejected in this circuit. The Debtor therefore lacks any viable  
2 legal argument to deviate from the Bankruptcy Code’s priority scheme to prefer certain unsecured  
3 creditors over all other estate creditors, warranting denial of the Motion.

4 **A. Section 105 Does Not Permit Deviation From Express Code Provisions.**

5 The Debtor misplaces reliance on Bankruptcy Code section 105, which authorizes a  
6 bankruptcy court to “issue any order, process or judgment that is necessary or appropriate to carry  
7 out the provisions of this title.” 11 U.S.C. § 105(a). Despite the broad statutory language, the  
8 Supreme Court verified the limited scope of Section 105:

9 It is hornbook law that § 105(a) ‘does not allow the bankruptcy court to override  
10 explicit mandates of other sections of the Bankruptcy Code.’ Section 105(a)  
11 confers authority to ‘carry out’ the provisions of the Code, but it is quite  
12 impossible to do that by taking action that the Code prohibits. That is simply an  
application of the axiom that a statute’s general permission to take actions of a  
certain type must yield to a specific prohibition found elsewhere.

13 *Law v. Siegel*, 134 S.Ct. 1188, 1194 (2014) (citing 2 Collier on Bankruptcy ¶ 105.01[2], p. 105–6  
14 (16th ed. 2013)). The Debtor cites only cases predating *Law v. Siegel* for the proposition that  
15 Section 105 permits a bankruptcy court to override the statutory priority of claims as set forth in  
16 the Bankruptcy Code. *See* Motion, at 10-11 (citing to cases ranging in dates from 1882-2002).

17 Section 507(a) of the Bankruptcy Code expressly establishes claim priority, and  
18 distributions to prepetition creditors must follow the Bankruptcy Code’s priority scheme within  
19 the context of a plan of reorganization. *See* 11 U.S.C. § 507(a); Fed. R. Bankr. P. 3021. Section  
20 105 therefore does not provide legal support to elevate payment of certain vendors’ unsecured  
21 prepetition claims to a higher, superadministrative-level priority.

22 **B. The Doctrine Of Necessity Does Not Permit The Debtor To Pay Prepetition**  
23 **Unsecured Creditors Outside Of A Plan.**

24 The Debtor completely ignored controlling Ninth Circuit law that rejects the “necessity of  
25 payment” doctrine as a means to alter the Bankruptcy Code’s priority scheme. *Matter of B & W*  
26 *Enters., Inc.*, 713 F.2d 534, 537 (9th Cir. 1983) (affirming the bankruptcy court’s avoidance of  
27 certain payments of prepetition claims made by a debtor in Chapter 11 proceedings before  
28 conversion to Chapter 7). In *B&W Enterprises*, the debtor operated a trucking company and

1 elected to pay prepetition claims to certain creditors - a parts and repair vendor, a fuel vendor, and  
2 a supplies vendor - concluding that each of these creditors was “necessary and essential to the  
3 [postpetition] operation of the debtor’s business.” *Id.*, at 535. The Ninth Circuit analyzed the  
4 “necessity of payment” rule, observing its Bankruptcy Act origins applicable to railroad  
5 reorganizations. The rule does not exist in the Bankruptcy Code, and the Ninth Circuit  
6 appropriately refused to recognize the rule beyond the context of railroad reorganizations finding  
7 it “unwise to tamper with the statutory priority scheme devised by Congress” in the Bankruptcy  
8 Code. *Id.*, at 537.

9 *B&W Enterprises* remains good law in this circuit, and has been applied uniformly to reject  
10 debtors’ attempts to use the necessity of payment doctrine to pay certain preferred prepetition  
11 creditors outside of a plan of reorganization. *See, e.g., In re Berry Good, LLC*, 400 B.R. 741, 746  
12 (Bankr. D. Ariz. 2008); *In re Timberhouse Post & Beam, Ltd.*, 196 B.R. 547, 549–50 (Bankr. D.  
13 Mont. 1996); *In re: EcoSmart, Inc.*, Case No. 2:15-BK-27139-RK, 2015 WL 9274245, at \*4  
14 (Bankr. C.D. Cal. Dec. 18, 2015). The Debtor’s Motion, like other debtors’ identical attempts,  
15 finds no basis in the law and should be denied.

16 The Debtor failed to identify any controlling authority upholding a debtor’s right to prefer  
17 certain prepetition creditors contrary to the express provisions of Section 507 of the Bankruptcy  
18 Code. The Debtor cited inapplicable Ninth Circuit cases that evaluate a debtor’s good faith in  
19 connection with obtaining postpetition financing under Bankruptcy Code section 364. *See*  
20 Motion, at 12 (*citing In re Adams Apple, Inc.*, 829 F.2d 1484, 1486, 1490 (9th Cir. 1987); and *In*  
21 *re Cooper Commons, LLC*, 424 F.3d 963, 969 (9th Cir. 2005), *amended and superseded* at 430  
22 F.3d 1215 (9th Cir. 2005)). Those cases, in pure dicta, identify circumstances not applicable to the  
23 Debtor where some courts authorized payment of prepetition claims. Neither of the Ninth Circuit  
24 cases cited by the Debtor abrogates *B & W Enterprises*’ limitation of the “necessity of payment”  
25 rule to railroad cases only.

26 To the extent it even matters given the Ninth Circuit’s strict prohibition on preferring  
27 prepetition creditors, UMB disputes that any of the creditors targeted in the Motion qualify as  
28 “critical vendors.” The Debtor only pursues a “critical vendor” argument as to IES, arguing

1 without evidence that the Debtor “must remain on good terms” with IES to readily obtain electric  
2 parts. The soft-pedaled argument suggests a way to otherwise negotiate “good terms” without  
3 paying prepetition claims, or that parts may still be acquired with more planning or on a slightly  
4 less convenient schedule. As presented, IES does not qualify as a “critical vendor.”

5 The Debtor does not offer a single, concrete example of actual harm if these creditors are  
6 not paid ahead of all other estate creditors. The Debtor’s argument relies heavily on a hypothetical  
7 parade of horrors, proposing that (1) these specific unpaid creditors *could* file liens against non-  
8 estate property, which *may* jeopardize the Debtor’s ability to collect on its accounts receivable; or  
9 (2) there is *a chance* that these specific creditors, if not immediately paid their prepetition  
10 unsecured claims, *may* file complaints with the general contractors that *may* negatively impact the  
11 Debtor’s reputation and ability to obtain future contracts. These are not circumstances unique to  
12 this Debtor; and the potential risks described by the Debtor exist in virtually all bankruptcy cases.  
13 Creditors who engaged in business with the Debtor prepetition must weigh the likelihood of  
14 recovering their prepetition claim against the opportunity for future business with the Debtor. The  
15 Court should not permit the Debtor to divert payment on prepetition claims based on potential  
16 harm, especially where no unique circumstances exist.

17 Even assuming, *arguendo*, that creditors enforce lien rights against non-estate property as a  
18 result of the Debtor’s non-payment of prepetition claims, creditors are not permitted to obtain  
19 possession of property of the estate; exercise control over property of the estate; enforce any lien  
20 against property of the estate; collect, assess, or recover a claim against the debtor that arose  
21 before the commencement of the case under this title; or setoff any debt owing to the debtor that  
22 arose before the commencement of the case. 11 U.S.C. § 362(a). Thus, while Section 546 may  
23 allow vendors to perfect and maintain materialman’s liens against non-estate property,  
24 withholding or offsetting payments owed to the Debtor may violate the automatic stay for which  
25 the Bankruptcy Code provides specific relief. *See* 11 U.S.C. § 362(a), (k). The Debtor is  
26 therefore protected against creditors reluctant to pay accounts receivable, thereby limiting the  
27 allegedly drastic impact of not paying prepetition claims outside of a plan.

1 The Motion makes little financial sense. The Debtor seeks to distribute over \$260,000 of  
2 cash in hopes of recovering \$500,000 in receivables, resulting in a net loss to the estate of  
3 \$20,000. The Debtor will suffer immediate negative impacts with certainty if the Court grants the  
4 Motion, and may only hypothetically suffer long-term negative impacts if the Court denies the  
5 Motion. Practically speaking, the Debtor has a demonstrated challenge collecting accounts  
6 receivable regardless of prepetition claim enforcement actions taken by creditors, as the lions'  
7 share of the Debtor's outstanding accounts receivable is aged well beyond 60 days. The Debtor's  
8 focus should be on prompt collections rather than preferred payments, especially because the  
9 Debtor is in or near administrative insolvency.

10 The Debtor's concern over reputational harm lacks merit. Whether warranted or not, a  
11 debtor in bankruptcy bears a reputational blow simply by virtue of filing a bankruptcy petition.  
12 Any reputational harm, if any, caused by non-payment of unsecured prepetition claims does not  
13 warrant deviating from the Bankruptcy Code's express priority scheme.

14 **C. UMB Is Entitled To Adequate Protection.**

15 The Debtor has failed to propose any adequate protection for UMB, and therefore has  
16 failed to sustain its burden of proof on the issue. 11 U.S.C. § 363(p)(1). To the extent the Court  
17 considers granting the relief requested in the Motion, UMB is entitled to adequate protection. 11  
18 U.S.C. § 363(e).

19 **D. No Basis For Waiver Of Bankruptcy Rule 6004(h).**

20 Federal Rule of Bankruptcy Procedure 6004(h) requires a 14-day stay of any order  
21 authorizing the use of estate property "unless the court orders otherwise." The Debtor has simply  
22 requested, without any rationale, a waiver of the 14-day stay of the effectiveness of such order.  
23 UMB objects to the groundless waiver of the stay.

24 **IV. CONCLUSION.**

25 UMB continues to oppose the use of its cash collateral for any reason, including to fund  
26 the Debtor's prepetition unsecured obligations. The Debtor does not have the legal authority or  
27 the financial wherewithal to make payments to prepetition unsecured creditors while leaving  
28

1 UMB, a secured creditor holding higher priority, unprotected. The estate cannot afford to further  
2 deplete cash to pay prepetition unsecured claims outside the context of a confirmed plan, thereby  
3 harming all of the Debtor's creditors, including UMB. Based on the foregoing, UMB respectfully  
4 requests that the Court enter an order:

- 5 a. Denying the Motion; and  
6 b. Granting UMB such other and further relief as the Court deems appropriate  
7 under the circumstances.

8 DATED this 6th day of March, 2017.

9 BRYAN CAVE LLP

10  
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